



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-84820; File No. SR-IEX-2018-23]

Self-Regulatory Organizations; Investors Exchange LLC; Notice of Filing of Proposed Rule Change to Modify the Resting Price of Discretionary Peg Orders

December 13, 2018.

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b-4 thereunder,³ notice is hereby given that, on November 30, 2018, the Investors Exchange LLC (“IEX” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”),⁴ and Rule 19b-4 thereunder,⁵ IEX is filing with the Commission a proposed rule change to modify the resting price of Discretionary Peg orders to be equal to the less aggressive

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ 15 U.S.C. 78s(b)(1).

⁵ 17 CFR 240.19b-4.

of one (1) MPV⁶ less aggressive than the primary quote (i.e., the NBB for buy orders and NBO for sell orders) or the order's limit price, rather than the primary quote.

The text of the proposed rule change is available at the Exchange's website at www.iextrading.com, at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this proposed rule filing is to modify the resting price of Discretionary Peg orders to be equal to the less aggressive of one (1) MPV⁷ less aggressive than the primary quote or the order's limit price, rather than the primary quote. Currently, the Exchange offers three types of pegged orders – primary peg, midpoint peg, and Discretionary Peg – each of which are non-displayed orders that upon entry into the System and while resting on the Order Book,

⁶ See Rule 11.210.

⁷ See Rule 11.210.

are automatically pegged to a reference price based on the national best bid and offer (“NBBO”).

As set forth in Rule 11.190(b)(10), a Discretionary Peg order is a pegged order that upon entry into the System, the price of the order is automatically adjusted to be equal to the less aggressive of the Midpoint Price⁸ or the order’s limit price, if any. Furthermore, when unexecuted shares of a Discretionary Peg order are posted to the Order Book, the price of the order is automatically adjusted by the System to be equal to and ranked at the primary quote or the order’s limit price, and is automatically adjusted by the System in response to changes in the NBB (NBO) for buy (sell) orders up (down) to the order’s limit price, if any.

In order to meet the limit price of active orders on the Order Book, a Discretionary Peg order will exercise the least amount of price discretion necessary from the Discretionary Peg order’s resting price to its discretionary price (i.e., the less aggressive of the Midpoint Price or the Discretionary Peg order’s limit price, if any), except during periods of quote instability as defined in Rule 11.190(g), discussed further below. When exercising price discretion, a Discretionary Peg order maintains time priority at its resting price and is prioritized behind any non-displayed interest at the discretionary price for the duration of that book processing action. If multiple Discretionary Peg orders are exercising price discretion during the same book processing action, they maintain their relative time priority at the discretionary price. In the event the NBBO becomes locked or crossed, Discretionary Peg orders resting on or posting to the Order Book are priced one (1) MPV less aggressive than the locking or crossing price.⁹

Pursuant to Rule 11.190(g), the Exchange utilizes real time relative quoting activity of

⁸ See Rule 11.160(t).

⁹ See Rule 11.190(h)(3)(C)(ii) and (D)(ii).

certain Protected Quotations¹⁰ and a proprietary mathematical calculation (the “quote instability calculation”) to assess the probability of an imminent change to the current Protected NBB to a lower price or Protected NBO to a higher price for a particular security (“quote instability factor”). When the quoting activity meets predefined criteria and the quote instability factor calculated is greater than the Exchange’s defined quote instability threshold, the System treats the quote as unstable and the crumbling quote indicator (“CQI”) is on at that price level for two milliseconds, or until the CQI triggers again. During all other times, the quote is considered stable, and the CQI is off. The System independently assesses the stability of the Protected NBB and Protected NBO for each security.

When the CQI is on, Discretionary Peg orders do not exercise price discretion to meet the limit price of an active (i.e., taking) order. However, Discretionary Peg orders are eligible for execution at their resting price (i.e., at the NBB (NBO) for buy (sell) orders) when the CQI is on. Therefore, when IEX determines the quote to be unstable, Discretionary Peg orders are protected from trading more aggressively at a price that appears to be unstable, and thus imminently stale, between the primary quote and the Midpoint Price. However, Discretionary Peg orders remain susceptible to trading at the primary quote under such circumstances. For example, based on a recent analysis of data for May and June of 2018, the Exchange identified that 90% of Discretionary Peg order executions trade within the NBBO when the CQI is off, 88% of which execute at the Midpoint Price. However, of the remaining 10% of Discretionary Peg order

¹⁰ Pursuant to Rule 11.190(g), the Protected Quotations of the New York Stock Exchange, Nasdaq Stock Market, NYSE Arca, Nasdaq BX, Cboe BZX Exchange, Cboe BYX Exchange, Cboe EDGX Exchange, and Cboe EDGA Exchange.

executions that occur at the primary quote, 31% occur when the CQI is on.¹¹ Said differently, 31% of Discretionary Peg executions at the primary quote occur when IEX has determined the primary quote to be in transition to a less aggressive (more advantageous) price.

Therefore, in order to further protect resting Discretionary Peg orders from execution at a stale price, the Exchange proposes to modify the resting price of Discretionary Peg orders to be equal to the less aggressive of one (1) MPV less aggressive than the primary quote or the order's limit price, rather than the primary quote.

As proposed, upon entry into the System, Discretionary Peg orders will continue to be priced to the less aggressive of the Midpoint Price or the orders limit price (i.e., Discretionary Peg orders will continue to remove liquidity up to the Midpoint Price, subject to the order's limit price). Similarly, after posting to the Order Book, Discretionary Peg orders will continue to exercise the least amount of price discretion up (down) to the less aggressive of the Midpoint Price or the orders limit price, if any, to meet the limit price of active orders on the Order Book when the CQI is off.¹² Moreover, Discretionary Peg orders will continue to be available for execution at their resting price (i.e., the less aggressive of one (1) MPV less aggressive than the primary quote or the orders limit price) when the CQI is on. Furthermore, if the System determines the NBB (NBO) for a particular security to be an unstable quote, it will restrict buy

¹¹ The remaining 69% execute at the primary quote when the CQI is off because the limit price of the active orders removing the Discretionary Peg orders were priced at least as aggressive as the primary quote.

¹² The Exchange notes that the proposed resting price for Discretionary Peg orders will be the same as the resting price of Primary Peg orders pursuant to Rule 11.190(b)(8). Thus, as proposed, both Discretionary Peg and Primary Peg orders will rest at the less aggressive of one (1) MPV less aggressive than the primary quote or the order's limit price in relative time priority. Furthermore, when the CQI is off, Primary Peg orders are eligible to exercise discretion up (down) to the NBB (NBO) for buy (sell) orders up (down) to the order's limit price. Thus, as proposed, when exercising discretion, Primary Peg and Discretionary Peg orders will compete for execution with orders removing liquidity at the primary quote based on relative time priority.

(sell) Discretionary Peg orders in that security from exercising price discretion to trade against interest at or above (below) the NBB (NBO). The Exchange is not proposing to modify the handling of Discretionary Peg orders resting on or posting to the Order Book in locked and crossed markets. Thus, in the event the NBBO becomes locked or crossed, Discretionary Peg orders resting on or posting to the Order Book will continue to be priced one (1) MPV less aggressive than the locking or crossing price.¹³

Lastly, the Exchange is also proposing to make conforming changes to the description of the resting price of Discretionary Peg orders for purposes of ranking and priority in the Regular Market Session Opening Process for Non-IEX-Listed Securities, and IEX Auctions.¹⁴

2. Statutory Basis

IEX believes that the proposed rule change is consistent with the provisions of Section 6(b)¹⁵ of the Act in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁶ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Specifically, the Exchange believes the proposed rule change is consistent with the protection of investors and the public interest because it is designed to protect resting Discretionary Peg orders from adverse selection by limiting execution at the primary quote when the Exchange's probabilistic model identifies that the primary quote appears to be

¹³ See supra note 9.

¹⁴ See proposed Rule 11.231(a)(1)(iii) and Rule 11.350(b)(1)(A)(i)(c), respectively.

¹⁵ 15 U.S.C. 78f.

¹⁶ 15 U.S.C. 78f(b)(5).

moving adversely to them, thereby reducing the potential to execute at an imminently stale price and enhancing the overall execution experience of Discretionary Peg orders.

In addition, the Exchange believes that such protection is consistent with the protection of investors and the public interest because it may incentivize the entry of additional resting Discretionary Peg orders on the Exchange, thereby increasing the overall liquidity profile on the Exchange to the benefit of all market participants. Moreover, as noted in the Purpose section, resting Discretionary Peg orders generally provide liquidity and opportunities for price improvement to market participants removing liquidity on the Exchange during periods of quote stability. By incentivizing the entry of additional Discretionary Peg orders, the Exchange believes that the proposed changes may enhance the overall execution experience for other market participants removing liquidity on the Exchange during periods of quote stability.

Further, IEX believes that the proposal is consistent with protection of investors and the public interest in that the Discretionary Peg order type is designed to assist Members in obtaining best execution for their customers (and proprietary orders) by providing an opportunity to execute at the NBBO, but limiting executions at the NBBO when the NBBO appears to be unstable, thereby reducing the potential to execute at an imminently stale price.

In addition, as noted in the Purpose section, the proposed resting price for Discretionary Peg orders will be the same as the resting price of Primary Peg orders pursuant to Rule 11.190(b)(8).¹⁷ Thus, IEX does not believe that the proposed changes raise any new or novel issues that have not already been considered by the Commission in connection with existing

¹⁷ As proposed, both Discretionary Peg and Primary Peg orders will rest at the less aggressive of one (1) MPV less aggressive than the primary quote or the orders limit price in relative time priority.

order types offered by the Exchange.¹⁸

Finally, the Exchange believes that the conforming change to the description of the resting price of Discretionary Peg orders for purposes of ranking and priority in the Regular Market Session Opening Process for Non-IEX-Listed Securities is consistent with the protection of investors and the public interest because it will make the Exchange's rules more accurate and complete, and descriptive of the System's functionality.

B. Self-Regulatory Organization's Statement on Burden on Competition

IEX does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. With regards to inter-market competition, the proposed resting price for Discretionary Peg orders will be the same as the resting price of Primary Peg orders pursuant to Rule 11.190(b)(8), and thus the Exchange believes that no new inter-market burdens are being imposed.¹⁹ Furthermore, the Exchange notes that other markets are free to adopt similar rules for comparable order types to the extent that the proposed changes pose a competitive threat to their business. In this regard, the Exchange notes that NYSE American LLC has adopted a rule copying an earlier iteration of the Exchange's Discretionary Peg order type and quote stability calculation.²⁰ Accordingly, the Exchange also believes that the proposed rule change will not result in any burden on inter-market competition that is not necessary or appropriate in furtherance of the purposes of the Act.

With regards to intra-market competition, the proposed change will modify the resting

¹⁸ See Securities Exchange Act Release No. 80223 (March 13, 2017), 82 FR 14240 (March 17, 2017) (SR-IEX-2016-18).

¹⁹ Id.

²⁰ See NYSE American Rule 7.31E(h)(3)(D).

price of all Discretionary Peg orders and will therefore be applied equally to all Members using the Discretionary Peg order type. Moreover, the Exchange does not believe that the proposed change to the resting price of Discretionary Peg orders will result in any burden on Members seeking to cross the spread and execute at the far side quote (the NBO (NBB) for buy (sell) orders). To the contrary, the proposed change would provide potential benefits to such Members. As discussed above, the enhanced benefits and protections offered by the Discretionary Peg order, as proposed, is intended in part to incentivize additional resting Discretionary Peg orders to be entered on the Exchange. Thus, Members seeking to cross the spread may be more likely to obtain price improvement for their liquidity removing orders to the extent such orders execute against a Discretionary Peg order during times when the CQI is off.

Moreover, as discussed in the Purpose and Statutory Basis sections, resting Discretionary Peg orders generally provide liquidity and opportunities for price improvement to market participants removing liquidity on the Exchange during periods of quote stability. Thus, the Exchange further believes that by enhancing the performance of Discretionary Peg orders, and thereby incentivizing additional order flow, the proposed changes may enhance the overall execution experience for other market participants seeking to cross the spread and execute at the far side quote during periods of quote stability, which is consistent with the protection of investors and the public interest.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include File Number SR-IEX-2018-23 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-IEX-2018-23. This file number should be included in the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the IEX's principal office and on its Internet website at www.iextrading.com. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-IEX-2018-23 and should be submitted on or before **[INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Eduardo A. Aleman,
Deputy Secretary.

²¹ 17 CFR 200.30-3(a)(12).

